Report

of the

Examination of

Heritage Mutual Insurance Company

Sheboygan, Wisconsin

As of December 31, 1999

TABLE OF CONTENTS

Page

October 27, 2000

Honorable Alfred W. Gross
Chairman, Financial Condition (E)
Committee, NAIC
Secretary, Southeastern Zone II, NAIC
Commissioner of Insurance
Commonwealth of Virginia
Tyler Building
Post Office Box 1157
Richmond, VA 23218

Honorable Donna Lee Williams
Secretary, Northeastern Zone I, NAIC
Superintendent of Insurance
State of Delaware
Rodney Building
841 Silver Lake Blvd.
Dover, DE 19904

Honorable Connie L. O'Connell
Commissioner of Insurance
State of Wisconsin
121 East Wilson Street
Madison, WI 53702

Honorable Sally McCarty
Secretary, Midwestern Zone III, NAIC
Commissioner of Insurance
State of Indiana
311 West Washington Street, Suite 300
Indianapolis, IN 46204-2787

Honorable Bob Lohr
Secretary, Western Zone IV, NAIC
Director of Insurance
State of Alaska
Post Office Box 110805
Juneau, AK 99811-0805

Commissioners:

In accordance with your instructions, a compliance examination has been made of the affairs and financial condition of:

HERITAGE MUTUAL INSURANCE COMPANY
Sheboygan, Wisconsin

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of the company was conducted in 1995 as of December 31, 1994. The current examination covered the intervening period ending December 31, 1999, and included a review of such 2000 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the company's operations, and included the following areas:

History
Management and Control
Corporate Records
Conflict of Interest
Fidelity Bonds and Other Insurance
Employes' Welfare and Pension Plans
Territory and Plan of Operations
Affiliated Companies
Growth of Company
Reinsurance
Financial Statements
Accounts and Records
Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the company's operations is contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

Independent Actuary's Review

Independent actuaries were engaged under a contract with the Office of the Commissioner of Insurance. They reviewed the adequacy of the company's loss reserves and loss adjustment expense reserves. The results of their work were reported to the examiner-in-charge. As deemed appropriate, reference is made in this report to the actuaries' conclusion.

II. HISTORY AND PLAN OF OPERATION

Heritage Mutual Insurance Company (hereinafter also “Heritage Mutual” or “the company”), a mutual property and casualty company operating under ch. 611, Wis. Stat., was incorporated in the state of Wisconsin on August 11, 1925, under the name of Mutual Automobile Insurance Company of the Town of Herman, and commenced business on September 25, 1925. Operations were initially restricted to Sheboygan county, Wisconsin, but the territory of the company was gradually extended. The name was changed in May 1954 to Mutual Auto Insurance Company of Wisconsin. The present name was adopted in December 1957. The company absorbed Bloomfield Mutual Insurance Company of West Bloomfield, Wisconsin, through a merger on January 22, 1982.

Heritage Mutual has approximately 614 employees. The company also provides employees, office facilities, and general administrative services to certain of its affiliates. All expenses for shared arrangements are initially paid by Heritage Mutual. Expenses other than taxes are then allocated on the basis of budget center utilization estimates and time studies. Tax allocations are established in accordance with written agreements described in the section of this report entitled “Affiliated Companies.” Intercompany balances with affiliates are created in the normal course of business, with settlements generally made on a monthly basis.

Business is written through approximately 8,564 agents operating out of 907 independent agencies, including 88 agents in 23 of the company’s affiliated agencies, all of which are in Wisconsin. The affiliated agencies wrote $15,188,008 in premiums for Heritage Mutual, which represents 8.8% of the company’s Wisconsin premiums. The company uses standard contract forms and commission schedules for its agents. Agents are compensated according to the following commission schedule:

Commercial Lines	Commission Rates
Bis-Pak and Comco packages	17.5% to 20%
Commercial property	15% to 25%
General liability	22.5% to 25%
Commercial auto	10% to 15%
Garage	15% to 17.5%
Worker’s compensation	5% to 10%
Commercial inland marine	17.5% to 20%
Surety and crime, including fidelity	5% to 25%

Commercial umbrella	15%
Farm	Refer to Company

Personal Lines	**Commission Rates**
Road and residence packages	15%
Auto policies under various plans	10% to 15%
Recreational vehicles	20%
Liability and personal umbrella	15% to 25%
Homeowner’s	15% to 30%
Fire and lightning	22.5% to 25%
Inland marine	17.5% to 25%
Boatowners	17.5% to 20%

In addition, any agent who produces at least $150,000 in annual net premiums written is eligible to participate in the profits earned by the company from their production. Contingent commission rates vary from 10% to 50% of the profit derived from the agent’s production, depending on volume written.

The company writes direct premium in the following states:

Wisconsin	$172,469,673	64.8%
Ohio	18,917,534	7.0
Indiana	16,141,242	6.0
Iowa	15,080,223	5.7
South Dakota	10,600,534	4.0
All other	32,873,543	12.5
Total	$266,082,749	100.0%

As of the examination date, the company was licensed in the following 31 states:

Alabama	Iowa	Ohio
Arizona	Kansas	Oregon
Arkansas	Kentucky	Pennsylvania
Colorado	Michigan	South Dakota
Delaware	Minnesota	Tennessee
Florida	Mississippi	Texas
Georgia	Missouri	Virginia
Idaho	Nebraska	Washington
Illinois	Nevada	West Virginia
Indiana	North Dakota	Wisconsin
		Wyoming

The company has also been issued a certificate of authority by the United States Department of the Treasury with respect to the issuance of surety bonds permitted or required by the laws of the United States.

In the state of Wisconsin, the company is licensed to transact all lines of property and casualty business as defined by s. Ins 6.75 (2), Wis. Adm. Code, except title, mortgage guaranty, credit, legal expense, and credit unemployment.

Personal automobile and homeowner's liability coverages are limited to a maximum of $1,000,000. Personal umbrella coverage is written up to a limit of $5,000,000. While there is no established maximum homeowner's property coverage limit, there are very few homes insured for more than $500,000. Heritage Mutual places no minimum or maximum coverage limitations on its commercial risks. Any commercial risk requiring coverage beyond treaty reinsurance limits utilizes facultative reinsurance, with Heritage Mutual carrying no retention on the facultative layer.

The following table is a summary of the net insurance premiums written by the company in 1999. The growth of the company is discussed in the Financial Data section of this report.

Line of Business	Direct Premium	Reinsurance Assumed	Reinsurance Ceded	Net Premium
Fire	$ 875,629	$	$ 33,331	$ 842,298
Allied lines	436,421		12,729	423,692
Homeowner's multiple peril	22,271,015		725,701	21,545,314
Commercial multiple peril	56,872,238		2,709,266	54,162,972
Inland marine	2,818,524		78,147	2,740,377
Worker's compensation	61,051,692		1,523,301	59,528,391
Other liability - occurrence	3,134,757		181,243	2,953,514
Products liability - occurrence	72,927			72,927
Private passenger auto liability	39,982,679	9,866,817	120,000	49,729,496
Commercial auto liability	28,793,093		391,792	28,401,301
Auto physical damage	46,444,117	4,967,863	527,615	50,884,365
Fidelity	348,176			348,176
Surety	2,705,662		20,000	2,685,662
Boiler and machinery	275,819		275,819	
Total All Lines	$266,082,749	$14,834,680	$6,598,944	$274,318,485

III. MANAGEMENT AND CONTROL

Board of Directors

The board of directors consists of thirteen members. Four to five directors are elected annually to serve a three-year term. Officers are elected at the board's annual meeting. Board members currently receive a director's fee of $20,000 annually, $1,000 per meeting for any special or agency meeting attended, and reimbursement for reasonable business expenses. Members of Heritage Mutual's board also serve as members of other boards of directors within the holding company system, but receive no additional compensation specific to their service on such boards.

Currently the board of directors consists of the following persons:

Name and Residence	Principal Occupation	Term Expires
Michael J. Bills Rancho Santa Fe, California	Managing Partner at Brandes Investment Partners of San Diego, CA	2001
James A. Feddersen Brookfield, Wisconsin	Lawyer and Partner at Whyte, Hirschboeck Dudek Law Firm of Milwaukee, WI	2001
Edward C. Fordney Manitowoc, Wisconsin	Retired President of Associated Bank Manitowoc, WI	2002
H. Gaylon Greenhill Whitewater, Wisconsin	Retired Chancellor of University of Wisconsin – Whitewater	2001
Donald C. Herzfeldt Sheboygan, Wisconsin	Retired Senior Vice President of Heritage Mutual Insurance Company	2003
Kenneth O. Nelson Lady Lake, Florida	Retired Medical Clinic Administrator & Consultant with Towers Perrins	2002
David F. Pauly Plymouth, Wisconsin	Executive Vice President & COO of Heritage Mutual Insurance Company	2003
Benjamin M. Salzmann Howards Grove, Wisconsin	President & CEO, Heritage Mutual Insurance Company	2003
Carol Skornicka Milwaukee, Wisconsin	Senior Vice President, Secretary & General Counsel for Midwest Express Airlines	2001
George K. Steil, Sr. Janesville, Wisconsin	Lawyer and Partner at Brennan, Steil, Basting & MacDougall Law Firm	2002
Robert T. Willis Sheboygan, Wisconsin	Physician and President Sheboygan Clinic	2001

Richard G. Zimmermann Sheboygan, Wisconsin	President Zimmermann Printing Co.	2002

The board of directors currently has a vacancy due to the death of a board member.

Officers of the Company

The officers appointed by the board of directors and serving at the time of this examination are as follows:

Name	Office	Compensation
Benjamin M. Salzmann	President and Chief Executive Officer	$436,454
David F. Pauly	Executive Vice President and Chief Operating Officer	436,188
Harold C. Trescott	Senior Vice President-Finance and Treasurer	169,599
Ira W. Sangerl	Senior Vice President-Administration, Planning, and Development	149,514
Edward L. Felchner	Vice President-Marketing and Personal Lines	155,862
Richard R. Waldhart	Vice President-Sales	123,604
James J. Loiacono	Vice President-Claims	123,535
Scott A. Romito	Vice President-Actuary	116,176
Neal J. Ruffalo	Vice President-Information Technology	99,188
Sheri L. Murphy	Vice President-Services	99,156
Edgar N. Warren	Vice President-Commercial Insurance	45,905
Donald C. Herzfeldt	Secretary	6,000*

* Donald C. Herzfeldt was appointed secretary during 2000 and compensation above reflects current year's salary.

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The committees at the time of the examination are listed below:

Executive Committee
George K. Steil, Sr., Chair
James A. Feddersen
Kenneth O. Nelson
Robert T. Willis
Benjamin M. Salzmann

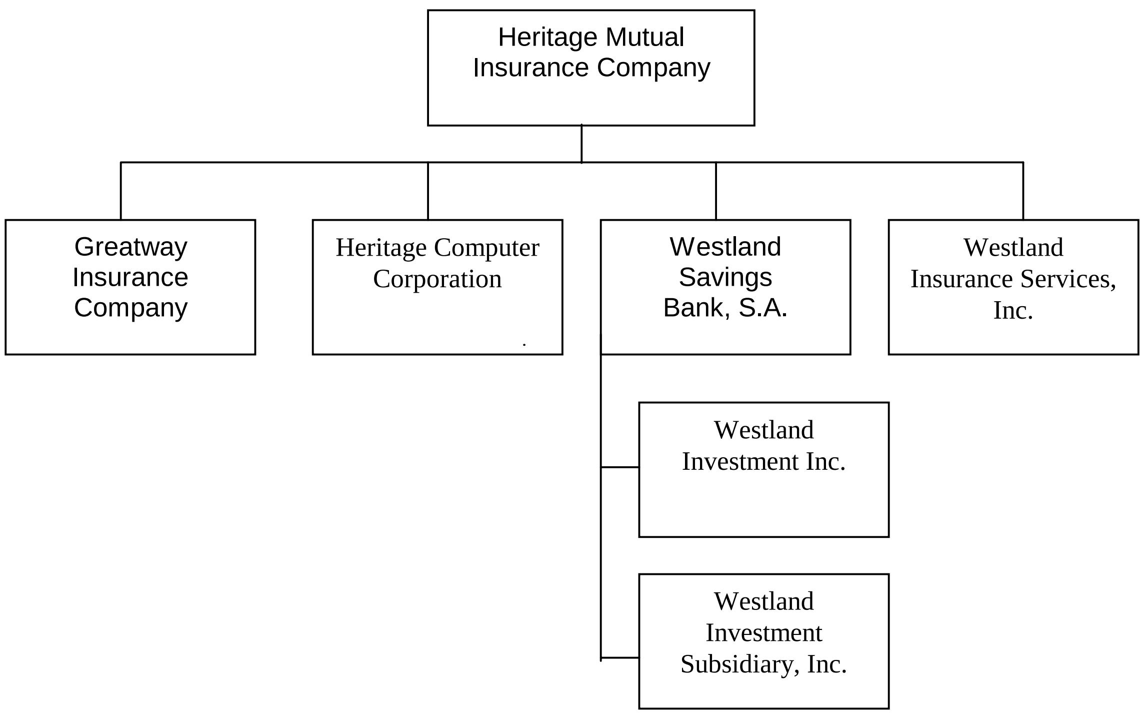
Audit Committee
Carol Skornicka, Chair
H. Gaylon Greenhill
Donald C. Herzfeldt

Finance Committee
Richard G. Zimmermann, Chair
Edward C. Fordney
Michael J. Bills
David F. Pauly

IV. AFFILIATED COMPANIES

Heritage Mutual Insurance Company is the ultimate parent of a holding company system and markets a broad range of personal and commercial insurance products. The company is the direct parent to one insurance company, a state-chartered savings bank, an insurance services company and a computer services subsidiary, which has been dormant since 1997. Through Westland Savings Bank, S.A., Heritage Mutual exercises control of two indirect wholly owned investment companies. The organization chart below depicts the relationships among the affiliates in the group. A brief description of the subsidiaries follows the organizational chart.

Organizational Chart
As of December 31, 1999



Greatway Insurance Company

Greatway was incorporated in Wisconsin on August 3, 1987, and commenced operations on August 29 of the same year. The company cedes all business to its parent, and as of June 1, 2000, is no longer writing any policies. Greatway will continue as a licensed insurance carrier, running off its existing business. As of December 31, 1999, the company reported net income of $605,152, assets of $10,699,327, liabilities of $1,328,623, and policyholders' surplus of $9,370,704. Greatway was examined concurrently with Heritage Mutual as of December 31, 1999, and the results of that examination were expressed in a separate report.

Noninsurance Subsidiaries

Heritage Computer Corporation

Heritage Computer Corporation (HCC) was organized on January 2, 1979, to provide data processing services, programming, and systems development for the company and the insurance industry in general. During 1998, it was determined that the stock of Heritage Computer Corporation (HCC) was impaired. Accordingly, the book value of HCC was reduced to its net realizable value of zero, resulting in a $4,035,000 realized capital loss. For additional comment regarding the current status of this Noninsurance Subsidiary see the section of this report titled "Subsequent Events."

Westland Insurance Services, Inc.

Westland Insurance Services, Inc. (Westland Services), organized in December 1974, is an owner and operator of insurance agencies, with 23 offices in Wisconsin. Effective December 31, 1999, Heritage Financial Corporation was merged into Westland Services, the surviving corporation. Westland Services also provides management services to Black River Falls Insurance Center, LLC, and English Agency General Partnership. The December 31, 1999, unconsolidated financial statements report net loss of $291,933, assets of $5,273,015, liabilities of $1,121,340, and stockholder's equity of $4,151,675. For additional comment regarding the current status of this Noninsurance Subsidiary see the section of this report titled "Subsequent Events."

Westland Savings Bank, S.A.

Westland Savings Bank, S.A. (Westland) is a Wisconsin-chartered savings bank headquartered in Tomah, Wisconsin, with seven offices in west central Wisconsin. Westland was incorporated in January 1952. On January 31, 1991, Heritage Mutual acquired all outstanding shares of the corporation for $5,492,408 in cash. The consolidated financial statements of Westland include the accounts of its wholly owned subsidiaries, Westland Investment Services, Inc., and Westland Investments Subsidiary, Inc. As of December 31, 1999, the consolidated financial statements reported net income of $121,178, assets of $141,758,408, liabilities of $130,153,695, and stockholder's equity of $11,604,713.

Direct Subsidiaries of Westland Savings Bank

Westland Investments, Inc.

Westland Investments, Inc. (WII) is an investment company that has a relationship with Fortis, an investment brokerage house. The bank buys and sells all types of investment products on behalf of its customers. The December 31, 1999, equity in WII was $174,603. This equity was included in the consolidated balance sheet of Westland Savings Bank.

Westland Investment Subsidiary

Westland Investment Subsidiary, Inc. (WIS) is incorporated in the state of Nevada. It is an investment company that receives capital from Westland Savings Bank and invests it primarily in short-term cash investments. The income generated from the investments then is exempt from any state income tax. The December 31, 1999, equity in WIS was $16,153,258. This equity was included in the consolidated balance sheet of Westland Savings Bank.

Written Agreements with Affiliates

The company has four tax allocation agreements, one with each of its direct subsidiaries. The contractual provisions of the agreements with Westland Savings Bank and Westland Insurance Services are identical, and are summarized as follows:

1. The agreements are dated June 22, 1992, to memorialize oral agreements effective January 1, 1991, between each of the affiliates and Heritage Mutual Insurance Company (Heritage).

2. Each subsidiary's federal income taxes are to be filed on a consolidated basis with Heritage Mutual; and each subsidiary will remit its estimated payments for its allocated share of the consolidated income tax obligation by cash payment to Heritage.

3. Heritage shall bill each affiliate for an amount not to exceed the amount of tax each affiliate would have paid had a tax return been filed on a separate return basis.

4. Heritage shall bill each affiliate for its allocated share to be paid in cash to Heritage but such billing shall not be made prior to the approximate time that estimated tax payments or income tax returns are submitted to the IRS.

5. Should either affiliate incur a taxable loss, Heritage will reimburse in cash to the extent that there is a tax benefit arising from these losses in the consolidated return as deemed in a manner consistent with the allocation of taxes to profitable subsidiaries.

The contractual provisions of the agreements with Greatway Insurance (Greatway) and Heritage Computer Corporation (HCC) are identical, and are summarized as follows:

1. The agreements are dated June 22, 1992, to memorialize oral agreements effective August 3, 1987, between Heritage and Greatway and the agreements are dated June 22, 1992, to memorialize oral agreements effective January 1, 1981, between Heritage and HCC.

2. Each affiliates federal income tax will be filed on a consolidated basis with Heritage and both affiliates will remit its estimated payments for its allocated share of the consolidated income tax obligation by cash payment to Heritage.

3. Heritage shall bill each affiliate for its allocated share of any consolidated tax liability, if any, based upon the proportion of either affiliates taxable income to consolidated taxable income without regard to any taxable losses.

4. Heritage shall bill each affiliate for its allocated share to be paid in cash to Heritage, but such billing shall not be made prior to the approximate time that estimated tax payments or income tax returns are submitted to the IRS.

5. Heritage shall not reimburse each affiliate for the benefit of any taxable losses utilized in the calculation of the consolidated tax liability.

The fifth cited provision would be unfair and unreasonable to Greatway were it not for the nature of the reinsurance agreement that has existed with Heritage Mutual since the commencement of Greatway's operations. Under this contract, Heritage Mutual effectively pays all losses, loss adjustment expenses, and underwriting expenses associated with business written by Greatway. In consequence of this agreement and its practical operation, it is fair and reasonable for Heritage Mutual to assume the advantage of tax losses, if any, occasioned by business assumed from Greatway.

The annual holding company registration statement filed pursuant to s. Ins 40.03, Wis. Adm. Code, and dated May 30, 2000, identifies the existence of written management service agreements with certain affiliates. Examiners reviewed these agreements as part of their examination. For additional information see Section VII under the heading “Corporate Records.”

V. REINSURANCE

The company's reinsurance treaties in force at the time of the examination are summarized below. The contracts contained proper insolvency provisions.

Nonaffiliated Ceding Contracts

1. Type: Multiple Line Excess of Loss

Reinsurer: Various as brokered through John P. Woods, Co. Inc. See Exhibit A at the end of this section.

Scope: Section A: Property

Section B: Casualty

Effective date: January 1, 2000

Termination: January 1, 2001

Premium: 1.30% applied to the subject net earned premium and an annual deposit premium of $3,319,000 subject to a minimum of $2,655,000

a. Section A – Property Per Risk

Retention: $1,000,000 each risk, each loss. A per occurrence limit of $10,000,000

Coverage: Up to $5,000,000 each risk each loss in excess of the company's retention

Commission: None

b. Section B – Casualty Excess of Loss (First Layer)

Retention: Up to $1,000,000 ultimate net loss each and every event except occupational disease and cumulative injury

Coverage: Up to $9,000,000 ultimate net loss each and every event except occupational disease and cumulative injury in excess of the company's retention. As respects business subject to aggregate coverage, reinsurers pay $9,000,000 in the aggregate any one insured, any one policy in excess of $1,000,000

2. Type: Casualty Excess of Loss Reinsurance

Reinsurer: Various as brokered through John P. Woods, Co. Inc. See Exhibit B at the end of this section.

Scope: All business classified by the company as casualty business

Effective date: January 1, 2000

Termination:	January 1, 2001

a. Second Layer

Retention:	Up to $10,000,000 ultimate net loss each and every event except occupational disease and cumulative injury
Coverage:	Up to $10,000,000 ultimate net loss each and every event except occupational disease and cumulative Injury in excess of the company's retention. As respects business subject to aggregate coverage, reinsurers to pay $10,000,000 in the aggregate any one insured, any one policy year excess of $10,000,000 in the aggregate any one policy year. Two full reinstatements available calculated pro rata as to amount and 100% to time.
Premium:	Deposit premium of $415,000 payable quarterly in advance adjustable at 0.231% applied to the Gross Net Earned Premium Income, subject to an annual minimum premium of $332,000.

b. Third Layer:

Retention:	Up to $20,000,000 ultimate net loss each and every event except occupational disease and cumulative injury
Coverage:	Up to $12,000,000 ultimate net loss each and every event except occupational disease and cumulative injury in excess of the company's retention. As respects business subject to aggregate coverage, reinsurers to pay $10,000,000 in the aggregate any one insured, any one policy year excess of $20,000,000 in the aggregate any one policy year. Two full reinstatements being calculated pro rata as to amount and 100% as to time.
Premium:	Deposit premium of $212,000 payable quarterly in advance adjustable at 0.118% applied to the Gross Net Earned Premium Income; subject to an annual minimum premium of $169,600.

3. Type: Property Catastrophe Excess of Loss Reinsurance

Reinsurers:	Various as brokered through J.P. Woods Co., Inc. See Exhibit C at the end of this section.
Scope:	Property risks classified by the company as property
Reinstatement:	For each of the six layers one full reinstatement being calculated pro rata as to amount and 100% to time.
Commission:	None
Effective date:	January 1, 2000
Termination:	January 1, 2001

a. First Layer

Retention:	$2,0000,000 ultimate net loss each and every occurrence

Coverage:	100% of $2,000,000 ultimate net loss each and every loss occurrence in excess of the retention
Premium:	0.6530% applied to Subject Earned Premium Income. Annual deposit of $493,000 payable in equal quarterly installments in advance subject to an annual minimum premium of $395,000.

b. Second Layer

Retention:	$4,000,000 ultimate net loss each and every loss occurrence
Coverage:	100% of $11,000,000 ultimate net loss each and every loss occurrence in excess of the retention
Premium:	1.026% applied to Subject Earned Premium Income. Annual Deposit of $770,000 payable in equal quarterly installments in advance subject minimum premium of $600,000.

c. Third Layer

Retention:	$15,000,000 ultimate net loss each and every loss occurrence
Coverage:	100% of $15,000,000 ultimate net loss each and every loss occurrence in excess of the retention
Premium:	0.5950% applied to Subject Earned Premium Income. Annual Deposit of $450,000 payable in equal quarterly installments in advance subject to an annual minimum premium of $360,00.

d. Fourth Layer

Retention:	$30,000,000 ultimate net loss each and every loss occurrence
Coverage:	100% of 12,500,00 ultimate net loss each and every loss occurrence in excess of the retention
Premium:	0.331% applied to Subject Earned Premium Income. Annual Deposit of $250,000 payable in equal quarterly installments in Advance subject to an annual minimum premium of $200,000.

e. Fifth Layer

Effective date:	June 1, 2000
Termination:	June 1, 2001
Retention:	$42,500,000 ultimate net loss each and every occurrence
Coverage:	100% of $20,000,000 ultimate net loss each and every loss occurrence in excess of the retention
Premium:	0.397% applied to Subject Earned Premium Income. Annual Deposit of $300,000 payable in equal quarterly installments advance subject to an annual minimum premium of $300,000.

f. Sixth Layer

Effective Date:	June 1, 2000
Termination:	June 1, 2001
Retention:	$62,500,000 ultimate net loss each and every occurrence
Coverage:	100% of $20,000,000 ultimate net loss each and every loss occurrence in excess of the retention
Premium:	0.291% applied to Subject Earned Premium Income. Annual Deposit of $220,000 payable in equal installments in advance subject to an annual minimum premium of $220,000.

4. Type: First Property Catastrophe Reinstatement Excess of Loss

Reinsurers:	Various as brokered through John P. Woods, Co. Inc. See Exhibit D at the end of this section
Scope:	All business classified as Property by the Reinsured
Retention:	$2,000,000 each and every loss occurrence. This agreement shall indemnify the Reinsured only after it has exhausted a $4,000,000 annual aggregate deductible of losses otherwise recoverable during the term of this Agreement.
Coverage:	$2,000,000 in excess of the company's retention
Premium:	$300,000 payable in full on June 1, 2000. In the event losses exceed $2,000,000 of the annual aggregate deductible, an additional premium will be calculated
Effective Date:	January 1, 2000
Expiration Date:	January 1, 2001

5. Type: Automatic Facultative Umbrella Reinsurance

Reinsurer:	Brokered by John P. Woods Co., Inc. a 100% with Zurich Reinsurance (North America) Inc.
Scope:	All business classified by the company as commercial umbrella casualty
Retention:	$5,000,000 ultimate net loss as respects any one loss, each occurrence
Coverage:	100% of $5,000,000 ultimate net loss each and every occurrence and every risk excess of $5,000,000
Premium:	There are four layers with premiums at 4%, 5%, 6%, and 7.5% of premium charged

Commission:	The agreement is subject to an annual minimum premium of $40,000 before application of the ceding commission, which is 27.5% of premiums ceded
Effective Date:	July 1, 1999
Termination:	Effective as of October 1999 the anniversary date of this treaty was changed to January 1 and subject to 30 days notice of cancellation any January 1.

6. Type: Workers' Compensation Catastrophe Excess of Loss

Reinsurer:	ReliaStar Life Insurance Company	50.0%
	Reinsurance Services of Princeton, LLC on behalf of American United Life Insurance Company	50.0%
Scope:	Workers Compensation losses occurring during the periods of January 1, 2000, to December 31, 2000, and reported to the reinsurer by January 1, 2006	
Retention:	$5,000,000	
Coverage:	$25,000,000 in excess of the retention each and every loss occurrence with one full reinstatement and additional premium pro rata as to time and amount. Maximum benefit attributable to any one person shall not exceed $5,000,000 at the date of commutation.	
Premium:	0.126% applied to gross net earned premium income. Annual minimum and deposit premium of $62,900.	
Effective Date:	January 1, 2000	
Expiration Date:	January 1, 2001	

Affiliated Assuming Contracts

1. Type: 100% Quota Share Reinsurance

Reinsured:	Greatway Insurance Company
Scope:	All business written by the reinsured
Ceding Company Retention:	None
Coverage:	100% of all loss and loss adjustment expenses incurred by the reinsured
Premium:	100% of all premiums written by the reinsured

Commission:	An amount equal to the actual underwriting expenses of the reinsured
Effective date:	August 28, 1987
Termination:	Upon 90 days' prior written notice by either party

Exhibit A
Multiple Line Excess of Loss
Participation Schedule

Reinsurer	
PMA Reinsurance Corporation	50.0%
Erie Insurance Exchange By: Erie Indemnity Company	40.0
Dorinco Reinsurance Company	7.0
Foreign Placement	
Hannover Ruckversicherungs – AG	3.0
Total	100.0%

Exhibit B
Casualty Excess of Loss Reinsurance
Participation Schedule

Reinsurer	Participation Second Layer	Participation Third Layer
Dorinco Reinsurance Company	3.00%	3.00%
Mutual Reinsurance Bureau	2.50	2.50
New Jersey Re-Insurance Company	2.25	2.25
PMA Reinsurance Corporation	10.00	10.00
St. Paul Reinsurance Co. Inc. on behalf of St. Paul Fire & Marine Insurance Company	7.50	7.50
Sydney Reinsurance Corporation	1.25	1.25
Transatlantic Reinsurance Company	10.00	10.00
Zurich Reinsurance (North America), Inc.	20.00	21.00
Foreign Placement		
Hannover Ruckversiucherungs – AG	15.00	15.00
London Placement		
Underwriters at Lloyd's	7.50	13.75
Terra Nova Insurance Company Limited, London England	12.50	
Zurich Versicherung-Aktiengsellschaft	8.50	13.75
Total	100.00%	100.00%

Exhibit C
Property Catastrophe Excess of Loss Reinsurance
Participation Schedule

Reinsurer	Participation First Layer	Second Layer	Third Layer	Fourth Layer	Fifth Layer	Sixth Layer
Copenhagen Re					2.87%	2.62%
Dorinco Reinsurance Company	14.50%		3.00%			
EMC Insurance Companies		1.00%	1.00	1.00%		
Erie Insurance Exchange By: Erie Indemnity Company	2.00	2.00	2.00	2.00		
Gerling Global Reinsurance Corp	5.00	13.50	7.50	8.50	5.00	5.00
Hart Re Company, L.L.C For and on behalf of Hartford Fire Insurance Company	5.00	5.00	7.50	7.50		
Insurance Corporation of Hannover	20.00					
Liberty Mutual Insurance Company	3.00	4.00	3.00	1.50		
Mutual Reinsurance Bureau	1.00	2.00	1.00	1.00	2.50	2.50
Nationwide Mutual Insurance Company			3.00	4.00		
Odyssey Re – TIG Re	3.00	4.00	4.00	4.00		
PMA Reinsurance Corporation	2.00	2.00	2.00	2.00		
Shelter Mutual Insurance Company	1.00	1.00	1.00	1.00		
Sorema North American Reinsurance		2.00	2.00	2.00		
St. Paul Fire & Marine Insurance Company on behalf of St. Paul Fire & Marine Insurance Company		3.50	1.50			
Sumitomo Marine Re Management Inc. U.S. Reinsurance Manager for the Sumitomo Marine & Fire Insurance Company, Ltd.			2.00	2.00		
Sydney Reinsurance Corporation			3.00	3.75	3.75	
Tempest Re (Bermuda)			30.00	30.00		
United Fire & Casualty Company				1.00		
Zurich Reinsurance (North America), Inc.			7.50	7.50		
<u>Foreign Placement</u>						
Hannover Ruckversicherung – AG		1.50	10.00	15.00	15.00	15.00
Renaissance Reinsurance Limited					2.00	
<u>London Placement</u>						
Underwriters at Lloyd's	42.18	54.12	32.84	31.61	40.87	41.13
Terra Nova Insurance Company Limited, London, England	1.32	6.57	3.98			
Zurich Versicherung-Aktiengesellschaft Reinsurance		1.31	3.18	1.89		
Totals	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

Exhibit D
Property Catastrophe Excess of Loss Reinsurance
Participation Schedule

Reinsurer	**First Layer Reinstatement**
Copenhagen Reinsurance Company	3.22%
Dorinco Reinsurance Company	14.50
Erie Insurance Exchange	2.00
Liberty Mutual Insurance Company	3.00
Mutual Reinsurance Bureau	1.00
Odyssey Reinsurance Company	3.00
Shelter Mutual Insurance Company	1.00
Underwriting Member of Lloyd's	52.28
Zurich Reinsurance (North America), Inc.	20.00
Total	100.00%

VI. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported in the December 31, 1999, annual statement to the Commissioner of Insurance. Also included in this section are schedules which reflect the growth of the company, comment on any exceptional NAIC Insurance Regulatory Information System (IRIS) ratio results for the period under examination, and the compulsory and security surplus calculation. Adjustments made as a result of the examination are noted in the section of this report captioned "Reconciliation of Surplus per Examination."

Heritage Mutual Insurance Company
Assets
As of December 31, 1999

	Ledger Assets	Nonledger Assets	Nonadmitted Assets	Admitted Assets
Bonds	$355,896,405	$	$	$355,896,405
Stocks:				
Preferred stocks	5,562,000		64,435	5,497,565
Common stocks	61,219,554	19,023,388		80,242,942
Real estate:				
Occupied by the company	15,662,027			15,662,027
Other properties	1,130,499			1,130,499
Cash/Short-term investments	13,449,353			13,449,353
Other invested assets	2,080,008			2,080,008
Agents' balances or uncollected premiums:				
Premiums and agents' balances in course of collection	14,094,396		809,408	13,284,988
Premiums, agents' balances, and installments booked but deferred and not yet due	59,027,996			59,027,996
Reinsurance recoverables on loss and loss adjustment payments	1,025,804			1,025,804
Federal income tax Recoverable		118,884		118,884
Electronic data processing equipment	1,824,649			1,824,649
Interest, dividends, and real estate income due and accrued		5,195,707		5,195,707
Receivable from parent, subsidiaries, and affiliates	355,509			355,509
Other assets:				
Furniture, equipment, and supplies	2,860,839		2,860,839	
Write-ins for noninvested assets:				
Prepaid insurance and other	14,925		14,925	
Due from sale of securities	228,000		8,000	220,000
Investment income due from trustees	7,750			7,750
Total Assets	$534,439,714	$24,337,979	$3,757,607	$555,020,086

Heritage Mutual Insurance Company
Liabilities, Surplus, and Other Funds
As of December 31, 1999

Losses	$169,280,305
Reinsurance payable on paid loss and loss adjustment expenses	851,058
Loss adjustment expenses	49,333,939
Contingent commissions and other similar charges	5,138,453
Other expenses (excluding taxes, licenses, and fees)	4,624,487
Taxes, licenses, and fees (excluding federal and foreign income taxes)	1,474,174
Unearned premiums	117,035,432
Dividends declared and unpaid:	
Policyholders	3,715,000
Amounts withheld or retained by company for the account of others	1,041,390
Provision for reinsurance	37,873
Excess of statutory over statement reserves	4,168,713
Drafts outstanding	6,501,165
Severance liability	817,889
Total Liabilities	364,019,878
Write-ins for special surplus funds:	
Undeclared dividends	11,470,000
Guaranty fund	1,500,000
Unassigned funds (surplus)	178,030,208
Surplus as Regards Policyholders	191,000,208
Total Liabilities, Surplus, and Other Funds	$555,020,086

Heritage Mutual Insurance Company
Summary of Operations
For the Year 1999

Underwriting Income	
Premiums earned	$258,756,370
Deductions	
Losses incurred	148,980,079
Loss expenses incurred	24,428,004
Other underwriting expenses incurred	82,882,597
Total underwriting deductions	256,290,680
Net underwriting gain or loss	2,465,690
Investment Income	
Net investment income earned	20,679,200
Net realized capital gains or losses	32,964,310
Net investment gain or loss	53,643,510
Other Income	
Net gain or loss from agents' or premium balances charged off	(327,387)
Finance and service charges not included in premiums	1,015,602
Write-ins for miscellaneous income:	
Home Office commissions	193,882
Other	541,316
Loss on leased property	(38,298)
Total other income	1,385,115
Net income before dividends to policyholders and before federal and foreign income taxes	57,494,315
Dividends to policyholders	11,038,433
Net income after dividends to policyholders but before federal and foreign income taxes	46,455,882
Federal and foreign income taxes incurred	2,976,718
Net Income	$ 43,479,164

Heritage Mutual Insurance Company
Cash Flow
As of December 31, 1999

Premiums collected net of reinsurance	$261,865,036		
Loss and loss adjustment expenses paid (net of salvage or subrogation)	163,729,410		
Underwriting expenses paid	81,180,175		
Other underwriting income (expenses)	22,920		
Cash from underwriting		$ 16,978,371	
Investment income (net of investment expense)		22,212,402	
Other income (expenses):			
Agents' balances charged off	(327,387)		
Net amount withheld or retained for account of others	112,520		
Write-ins for miscellaneous items:			
Finance and service charges	1,015,602		
Home office commissions	193,882		
Other	541,316		
Loss on leased property	(38,298)		
Total other income		1,497,635	
Deduct:			
Dividends to policyholders paid		9,228,433	
Federal income taxes paid (recovered)		(3,384,013)	
Net cash from operations			$28,075,962
Proceeds from investments sold, matured, or repaid:			
Bonds	135,772,914		
Stocks	54,141,384		
Real estate	1,963,384		
Other invested assets	87,394		
Total investment proceeds		191,965,076	
Cost of investments acquired (long-term only):			
Bonds	175,722,131		
Stocks	50,748,949		
Real estate	417,313		
Miscellaneous applications	207,750		
Total investments acquired		227,096,143	
Net cash from investments			(35,131,067)
Cash provided from financing and miscellaneous sources:			
Other cash provided	193,530		
Total		193,530	
Cash applied for financing and miscellaneous uses:			
Net transfers to affiliates	104,053		
Other applications	309,046		
Total		413,099	
Net cash from financing and miscellaneous sources			(219,569)
Net change in cash and short-term investments			(7,274,674)

Reconciliation

Cash and short-term investments, December 31, 1998	20,724,027
Cash and short-term investments, December 31, 1999	$13,449,353

Heritage Mutual Insurance Company
Compulsory and Security Surplus Calculation
December 31, 1999

Assets		$555,020,086	
Less investment in insurance subsidiaries not in excess of subsidiaries' security surplus		5,593,873	
Less liabilities		364,019,878	
Adjusted surplus			$185,406,335
Annual premium:			
Individual accident and health	$		
Factor	15%		
Total			
Group accident and health	0		
Factor	10%		
Total			
All other insurance	263,280,052		
Factor	20%		
Total		52,656,010	
Compulsory surplus (subject to a minimum of $2 million)			52,656,010
Compulsory surplus excess (or deficit)			$132,750,325
Adjusted surplus			$185,406,335
Security surplus: (140% of compulsory surplus, factor reduced 1% for each $33 million in premium written in excess of $10 million with a minimum of 110%)			70,032,493
Security surplus excess (or deficit)			$115,373,842

Heritage Mutual Insurance Company
Reconciliation and Analysis of Surplus
For the Five-Year Period Ending December 31, 1999

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements:

	1995	1996	1997	1998	1999
Surplus, beginning of year	$102,288,132	$108,631,054	$116,934,918	$151,894,861	$178,315,020
Net income	(6,981,098)	9,190,939	16,549,903	15,457,637	43,479,164
Net unrealized capital gains or (losses)	9,642,638	3,885,633	19,268,120	7,425,304	(30,932,238)
Change in nonadmitted assets	(501,825)	1,262,009	771,329	(157,970)	274,006
Change in provision for reinsurance	10,517	(24,517)	(47,376)	(18,765)	154,692
Change in foreign exchange adjustment					
Change in excess of statutory reserves over statement reserves	5,017,039	(6,010,200)	(1,582,033)	3,713,953	(290,433)
Extraordinary amounts of taxes from prior years	(844,349)				
Surplus, end of year	$108,631,054	$116,934,918	$151,894,861	$178,315,020	$191,000,211

Heritage Mutual Insurance Company
Insurance Regulatory Information System
For the Five-Year Period Ending December 31, 1999

The following is a summary of NAIC Insurance Regulatory Information System (IRIS) results for the period under examination. Exceptional ratios are denoted with asterisks. A discussion of the exceptional ratios may be found after the IRIS ratios.

	Ratio	1995	1996	1997	1998	1999
#1	Gross Premium to Surplus	259%	194%	151%	194%	147%
#1A	Net Premium to Surplus	239	183	143	133	144
#2	Change in Net Writings	(13)	(18)	2	9	15
#3	Surplus Aid to Surplus	0	0	0	0	0
#4	Two-Year Overall Operating Ratio	102*	103*	94	90	91
#5	Investment Yield	6.1	5.5	5.3	5.6	4.5
#6	Change in Surplus	2	6	26	16	8
#7	Liabilities to Liquid Assets	86	82	76	71	71
#8	Agents' Balances to Surplus	13	11	7	6	7
#9	One-Year Reserve Devel. to Surplus	18	(14)	(19)	(20)	(11)
#10	Two-Year Reserve Devel. to Surplus	19	10	(30)	(37)	(32)
#11	Estimated Current Reserve Def. To Surplus	(34)	(54)	(20)	(2)	(5)

In 1995 and 1996, the two-year overall operating ratios were exceptional. These exceptional ratios can partially be attributed to higher than expected losses related to some commercial risks. This is discussed further below.

While the investment yield was not exceptional it is below the industry average. The company's modest return is primarily due to the company's tax exempt holdings.

Growth of Heritage Mutual Insurance Company

Year	Admitted Assets	Liabilities	Surplus As Regards Policyholders	Net Income
1995	$483,673,049	$375,041,995	$108,631,054	$ (6,981,098)
1996	473,868,089	356,933,171	116,934,918	9,190,939
1997	492,223,317	340,328,456	151,894,861	16,549,903
1998	514,648,963	336,333,943	178,315,020	15,457,637
1999	555,020,086	364,019,878	191,000,208	43,479,164

Year	Gross Premium Written	Net Premium Written	Premium Earned	Loss And LAE Ratio	Expense Ratio	Combined Ratio
1995	$281,711,602	$259,750,503	$286,507,525	82.6%	27.4%	110.0%
1996	226,879,706	213,443,318	220,763,299	70.8	32.1	102.9
1997	229,220,854	217,700,203	212,386,361	66.4	33.1	99.5
1998	248,578,850	237,700,203	230,955,111	63.9	32.8	96.7
1999	280,917,429	274,318,485	258,756,370	67.0	32.0	99.0

In 1995, Heritage experienced high loss experience, and adverse development on its prior loss reserves, on its commercial business lines and as a result reduced its writings dramatically during 1996. All commercial lines were reunderwritten and the focus shifted away from larger, higher risk accounts. During 1999 the company's product mix closely resembles those obtained in 1995, but are comprised of smaller commercial risks. Heritage's largest commercial line of business is workers' compensation. Heritage's largest product for personal lines is private passenger automobile for which there are four different rating plans available.

Reconciliation of Surplus per Examination

The examination made no adjustments to the $191,000,208 in policyholders' surplus reported by the company as of December 31, 1999.

VII. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were six specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. Compulsory and Security Surplus - It is recommended that the company properly adjust the value of its investment in insurance subsidiaries on future filings of compulsory and security surplus calculations, pursuant to s. Ins 14.02, Wis. Adm. Code.

   Action—Compliance.

2. Management and Control - Board - It is recommended that committees of the board include at least three directors, as required by ch. 611.56 (1), Wis. Stat.

   Action—Compliance.

3. Corporate Records - It is recommended that the company adopt an intercompany expense allocation and management agreement which discloses the terms among participants for allocating expenses and for settling balances, pursuant to ch. 611.61, Wis. Stat.

   Action—Partial compliance, see comments in the summary of current examination results.

4. Common Stock - It is recommended that the company reregister its shares in the Investment Company of America to reflect ownership by Heritage Mutual Insurance Company, pursuant to ch. 610.23, Wis. Stat.

   Action—Noncompliance, see comments in the summary of current examination results.

5. Other Invested Assets - It is recommended that the company report subscription commitments outstanding at par value in the notes to the financial statement under the hearing "Contingent Liabilities" in accordance with the NAIC Annual Statement Instructions-Property and Casualty.

   Action—Compliance.

6. Receivable from Parent, Subsidiaries, and Affiliates - It is recommended that the company settle balances with affiliates on a timely basis, within 90 days after the due date. Investment contributions or write-offs should be made, if necessary, to clear balances for which settlement is impractical.

   Action—Compliance.

Summary of Current Examination Results

Management and Control

The examiners reviewed the biographical information on the company's officers and directors filed with this office. It was determined that the company has not updated the information to reflect changes in these positions. It is recommended that the company maintain with this office current biographical information on its officers and directors in compliance with s. Ins. 6.52, Wis. Adm. Code.

The examiners reviewed responses by the company to the “General Interrogatories” section of the annual statement. It was noted that the company did not properly disclose the fact that changes to its articles of incorporation had been made during the year. It is recommended that the company implement a procedure to ensure proper disclosures in the “General Interrogatories” section of future annual statements.

Common Stock

In the previous exam report it was recommended that the company reregister its shares of the Investment Company of America, an equity-oriented mutual fund, in the name of Heritage Mutual Insurance Company. These investments were originally acquired when the company absorbed all of the assets and liabilities of Bloomfield Mutual Insurance Company (Bloomfield Mutual), of West Bloomfield, Wisconsin, through a merger on January 22, 1982. Bloomfield Mutual was a town mutual insurer operating under ch. 612, Wis. Stat. As of the date of this examination report, the company had not reregistered these shares acquired in the Bloomfield Mutual merger in the name of Heritage Mutual Insurance Company. It is again recommended that the company reregister its shares in the Investment Company of America to reflect ownership by Heritage Mutual Insurance Company, pursuant to s. 610.23, Wis. Stat.

Bonds

Previous examinations since 1986 have noted the existence of several bonds with maturity dates ranging between December 1995 and October 2010 that were in the name of Bloomfield Mutual. The company holds these bonds on its premises rather than in the bank where the rest of the company's investments are held in safekeeping. The company had been receiving its regular interest and principal payments directly from the issuer, but had not reregistered these bonds in Heritage's name. It was hoped that as these bonds eventually matured, the company would simply redeem them for its face value, and so failure to reregister the bonds would be a self-correcting problem. In light of this assumption, no specific recommendations related to these bonds have been made. During 1995 and 1996 several of these bonds began to mature and the company was unsure as to how to proceed with collecting its final payment. The company has continued to report a receivable due from the sale of these securities since 1996. In 1999, the receivable due from the sale of these securities was $20,000. It is recommended that the company either seek settlement for these obligations or nonadmit due to the delay in settlement.

Corporate Records

Heritage Mutual provides office space, administrative services, internal audit functions, as well as other services to its various affiliates. The previous examination recommended that the company adopt an intercompany expense allocation and management agreement which discloses the terms among participants for allocating expenses and for settling balances, pursuant to s. 611.61, Wis. Stat. The company executed several agreements between the affiliates in response to the recommendation and as relationships between affiliates continued to change. However, it was noted that several of the affiliates were still being charged for services provided by Heritage Mutual, which had not been formalized in a written agreement. Signed written agreements help develop and maintain a division of accountability and responsibility. It is recommended that the company develop and execute the agreements necessary, which will clearly and accurately disclose the nature and details of all the various transactions amongst affiliates, for allocating expenses and for settling balances, pursuant to s. 611.61, Wis. Stat.

In addition, none of the current agreements were reported to the Commissioner prior to becoming effective, in compliance with s. 617.21, Wis. Stat., and s. Ins 40.04 (2), Wis. Adm. Code, as all would be subject to disapproval. It is recommended that the company submit all current agreements, or any amendment thereof, within 90 days from the adoption of this report and any future proposed agreements, at least 30 days in advance in compliance with s. 617.21, Wis. Stat., and s. Ins 40.04 (2), Wis. Adm. Code.

Compulsory and Security Surplus

Pursuant to s. 623.11, Wis. Stat., compulsory surplus is the amount of surplus " . . . that an insurer is required to have in order not to be financially hazardous." For a property and casualty insurer, this amount is generally equal to 20% of net annual premiums written (per s. Ins 51.80, Wis. Adm. Code). The calculation of the compulsory and security surplus is required to be filed with OCI annual and quarterly financial statements.

In September 1999, the company entered into a tax-advantaged investment swap (the swap), whereby; it exchanged common stock ownership in four bank holding companies for common stock in Belcrest Capital Fund, LLC (Belcrest). The exchange is not taxable at this time. However, the investment in Belcrest, which as of December 31, 1999, had a market value of $51,451,220, does exceed the class limitation for investments in common stock of a single corporation (3% of assets) prescribed in s. 620.23(2)(a), Wis. Stat. Pursuant to s. 620.22(9), Wis. Stat. (the "basket" clause), the company may include investments not specifically prohibited by statue, to the extent of not more than 5% of the first $500,000,000 of the insurer's assets plus 10% of the insurer's assets exceeding $500,000,000 for compulsory and security surplus calculations. The investment in Belcrest exceeds the benefit derived by the "basket" clause. Therefore, it is recommended that the company properly exclude the value in excess of the "basket" clause of its investment in Belcrest on future filings of compulsory and security surplus calculations, pursuant to s. Ins 51.80, Wis. Adm. Code.

Electronic Data Processing

A review of the company's password requirement for logical access to its network and mainframe applications identified that the length of the passwords were insufficient. Acceptable password lengths were discussed with the company for logical access. It is recommended that the company increase the required length of its password for network and mainframe access.

Changes to programs are placed in a validation library prior to the programs being promoted into production. At this point, no changes can be made to the programs. Programs are not placed in the validation library until after program testing is performed. There is no formal control to ensure changes are not allowed on a program after testing begins. It is recommended that the company establish a formal control to ensure that no changes are made to programs after programming is complete and the program is submitted to the testing phase.

Independent Actuary's Review

An independent actuarial firm was engaged under a contract with the Office of the Commissioner of Insurance to review the adequacy of the company's loss and loss adjustment expense reserves. The actuarial firm determined that the company's reserves were adequate and no adjustments were necessary. The paragraphs that follow contain a summary of those areas where adverse findings were noted or where unusual situations existed as determined by the actuaries.

Actuarial Documentation

The company's current methodology of establishing incurred-but-not-reported (IBNR) assumes that 40% of IBNR is for the adverse development of case reserves and 60% is for unreported losses. Although the adequacy of the reserves were not in question, the company did not provide sufficient documentation of the 40/60 split within the actuarial report to substantiate the rationale for its assumptions. It is recommended that the company sufficiently document the reasons for its assumptions regarding the 40/60 split of IBNR between case reserves and unreported losses.

Beginning in 1998, the definitions of Allocated and Unallocated loss expenses were clarified by the NAIC, and the names were changed to Defense and Cost Containment payments (DCC) and Adjusting and Other Payments (AO). The company's actuarial report was based on the old pre-1998 NAIC definition. Our actuary's estimate was based on the new definition and resulted in a higher estimate for the AO component than the company's. However, our actuary concluded that the difference is not critical and should be absorbed by the company's larger DCC reserve. Beginning on January 1, 2000 the company's claim system programming was completed and the company began to accumulate loss adjustment expense in accordance with the new definition. It is suggested that the company include analysis of Loss Adjusting Expenses on both the old and new definitions until there are sufficient years of experience to be able to rely on the new definition only for reserve establishment and analysis.

VIII. CONCLUSION

Growth in policyholders' surplus during the period was notably strong, increasing roughly 87%, from $102,288,132 as of year-end 1994, to $191,000,208 as of year-end 1999. There was a slight decrease in annual premium volume of 10% during the period, from $298,047,887 in direct premiums written in 1994 to $266,082,749 in 1999. However, direct premiums written decreased significantly during 1995 and 1996, to $261,513,110 and $213,122,597, respectively, and have steadily increased for the last three years to its current levels. Operating earnings have been profitable since 1996 due to the improved underwriting performance and steady investment income.

The examination resulted in ten recommendations. Four of the recommendations related to issues raised in previous examinations; however, only one recommendation was specifically repeated. The remainder of recommendations related to management's control of the company and the company's implementation of a more automated system. No adjustments to surplus were made as a result of this examination.

IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 35 - Management and Control—It is recommended that the company maintain with this office current biographical information on its officers and directors in compliance with s. Ins 6.52, Wis. Adm. Code.

2. Page 35 - Management and Control—It is recommended that the company implement a procedure to ensure proper disclosures in the "General Interrogatories" section of future annual statements.

3. Page 35 - Common Stock—It is again recommended that the company reregister its shares in the Investment Company of America to reflect ownership by Heritage Mutual Insurance Company, pursuant to s. 610.23, Wis. Stat.

4. Page 36 - Bonds—It is recommended that the company either seek settlement for these obligations or nonadmit due to the delay in settlement.

5. Page 36 - Corporate Records—It is recommended that the company develop and execute the agreements necessary, which will clearly and accurately disclose the nature and details of all the various transactions amongst affiliates, for allocating expenses and for settling balances, pursuant to s. 611.61, Wis. Stat.

6. Page 36 - Corporate Records—It is recommended that the company submit all current agreements, or any amendment thereof, within 90 days from the adoption of this report and any future proposed agreements, at least 30 days in advance in compliance with s. 617.21, Wis. Stat., and s. Ins 40.04 (2), Wis. Adm. Code.

7. Page 37 - Compulsory Surplus—It is recommended that the company properly exclude the value in excess of the "basket" clause of its investment in Belcrest on future filings of compulsory and security surplus calculations, pursuant to s. Ins 51.80, Wis. Adm. Code.

8. Page 37 - Electronic Data Processing—It is recommended that the company increase the required length of its password for network and mainframe access.

9. Page 38 - Electronic Data Processing—It is recommended that the company establish a formal control to ensure that no changes are made to programs after programming is complete and the program is submitted to the testing phase.

10. Page 38 - Actuarial Documentation—It is recommended that the company sufficiently document the reasons for its assumptions regarding the 40/60 split of IBNR between case reserves and unreported losses within the actuarial report.

X. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company is acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, state of Wisconsin, participated in the examination:

Name	Title
Randy Milquet	Insurance Financial Examiner
Danielle Rogacki	Insurance Financial Examiner
DuWayne Kottiwitz	Insurance Financial Examiner
Karla Harris	Insurance Financial Examiner
Malinda Feinhauer	Insurance Financial Examiner

Respectfully submitted,

Tim Vande Hey
Examiner-in-Charge
Insurance Financial Examiner

Heritage Mutual 1999.doc

XI. APPENDIX—SUBSEQUENT EVENTS

During December 2000, Heritage properly reported to this office its intention to merge Westland Insurance Services, Inc. into Heritage Computer Corporation, in compliance with holding company regulations, and this office did not disapprove the merger. Upon completion of the merger the corporate name was changed to Westland Insurance Services, Inc.